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## China, Peoples Republic of

### Dairy and Products

### Shanghai Cheese Market Profile

### 2006

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**Report Highlights:**

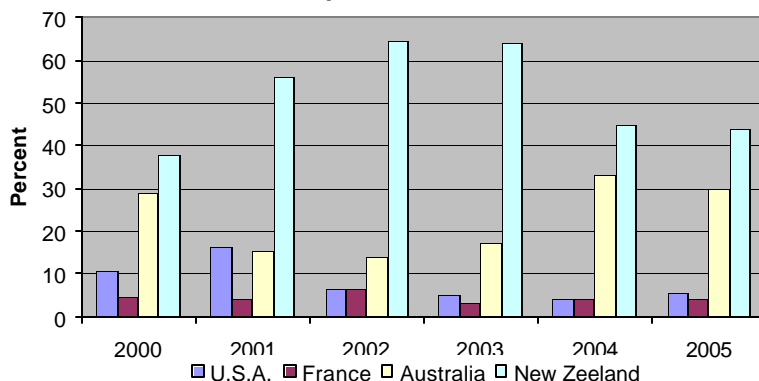
The market for cheese products in China is growing. While milk, yogurt, and assorted other products continue to drive the dairy market, cheese makes up a small but potentially important growth area. China is predicted to increase imports of cheese over the long term, but obstacles remain for U.S. companies interested in entering the market. Imports from competing countries make up a large share of cheese consumption. Compared to these countries, the U.S. faces a disadvantage in reduced shelf life due to differences in regulations on formulating shelf life time. However, U.S. firms have an opportunity to succeed in the cheese market if positioned early and establishing brand loyalty while the market is still new.

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## Introduction

**Table 1: China Imported Cheese Market Share**



Over the past five years, the Chinese dairy market has grown rapidly and is currently estimated at over \$9 billion. By 2010, the overall Chinese market will have doubled from 2005, growing to nearly \$20 billion (McKinsey Quarterly, April, 2006). Imports of dairy products also have increased from \$214.7 million in 2000 to \$458.9 million in 2005, and are expected to grow as demand increases. Milk, yogurt, and assorted other products continue to drive the dairy market, yet cheese makes up a small but

potentially important growth area. While making up only 2 percent of the dairy market in 2005, increasing incomes and western-influenced cuisine could expand the cheese market to levels seen in neighboring Asian countries of 12 – 22 percent. China is predicted to increase imports of cheese over the long term, but obstacles remain for U.S. companies interested in entering the market. Imports from competing countries make up a large share of the cheese market, and domestic production (while currently limited) could expand if the market grows more profitable. The U.S. also faces a disadvantage in reduced shelf life of its cheeses compared to imports from other countries due to longer transportation time to China. Other issues include the Chinese lack of incorporation of cheese into their cuisine, a number of lactose-intolerant consumers, cold-chain transportation problems, little U.S. brand recognition and U.S. company's limited knowledge of the Chinese market. U.S. firms have an opportunity to succeed in the cheese market if positioned early to deal with these issues while the market is still new.

## Market Size

Shanghai is China's most cosmopolitan urban center and its largest city, with a total population estimated as high as 20 million, including short-term residents (mostly service and construction workers) and an estimated 580,000 foreign national expatriates (mostly Taiwanese). Shanghai has one of the highest average per capita urban incomes in China at \$2,330 in 2005, with a growth rate of nearly 12% from the previous year.

Higher incomes and an increasingly busy lifestyle are changing people's dining patterns, with more people purchasing ready-to-eat meals and dining out instead of cooking at home. Shanghai has one of the highest rates of dining out in China with over 25% of all household spending on food spent dining out (China Yearbook, 2005). Growing numbers of local residents, expatriates, and tourists have all spurred the growth of a sophisticated and rapidly expanding hotel, restaurant and bar industry. In Shanghai alone, there are 24 five-star, 37 four-star, 132 three-star hotels, more than 200 Japanese restaurants, and an undocumented number of Korean and Western restaurants.

### Quick Facts

→ U.S. exports of cheese have grown by 1,808% from 2000-2005 in terms of value, and 1,523% by quantity.

→ The U.S. is the single largest supplier of grated or powdered cheese in China.

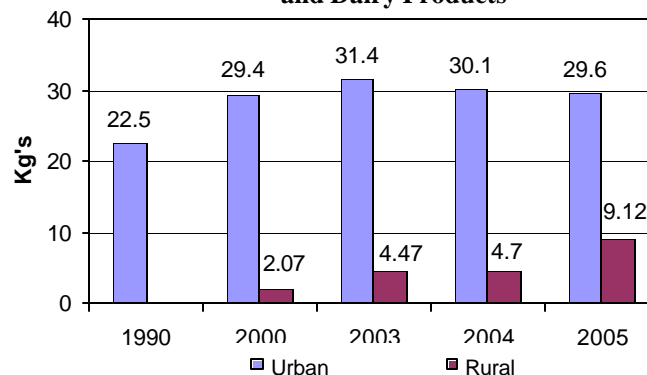
High incomes have also impacted the consumption of dairy products. Chinese cuisine does not typically incorporate the use of dairy, however, an increasingly western and urban population in Shanghai has begun to embrace a variety of dairy products. In Shanghai, higher incomes and a more health conscious populace have resulted in a greater consumption of dairy products with per capita spending on dairy growing from 65 RMB per year (\$8.13) in 1990 to 379 RMB (\$47.38) in 2005 (Shanghai Yearbook, 2005 year end data). By volume, Shanghai urban households have increased annual dairy consumption from 22.5 kg in 1990 to 29.6 kg in 2005, and rural households have grown from 2.07 kg in 2000 to 9.12 kg in 2005 (Table 2). This increase comes with changing attitudes about dairy's role in people's everyday diet. Previously, dairy products were considered to be only for infants, the sick and the elderly as a supplemental food source. Today, many Chinese people concerned about their diet are purchasing dairy products as a way to increase calcium consumption and other essential nutrients. While the total consumption number lags considerably behind the 2000 world average of 105 kg per person, it represents an ever growing market that has potential to increase to consumption levels of China's neighboring countries of Japan, Korea, and Taiwan with 70, 58 and 56 kg's of dairy consumption, respectively (Rabobank International, 2002). Moreover, Shanghai's average is higher than rural areas in China, and comparable to the average dairy consumption found in Beijing.

**Table 2: Per Capita Urban Household Annual Dairy Consumption Expenditures by Region (Unit RMB)**

Province	Milk and its products
Tibet	398.07
Beijing	255.79
<b>Shanghai</b>	<b>250.03</b>
Chongqing	183.91
Guangdong	127.39
National Average	132.37

Source: China Yearbook Statistics (2004)

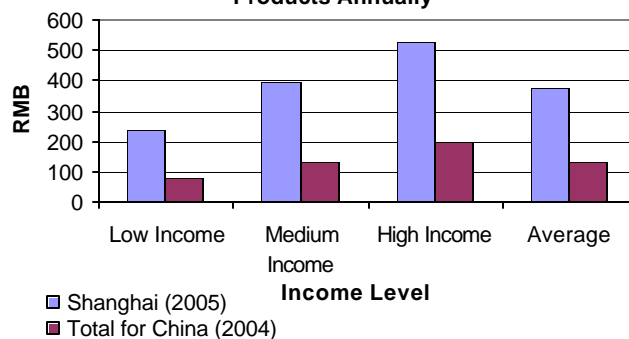
**Table 3: Per Capita Household Consumption of Milk and Dairy Products**



Source: Shanghai Yearbook Statistics (year end 2005)

Cheese follows this growth market trend. In 2005, sales increased 18% from the previous year to a total of \$49.7 million (CH6603). While still a relatively small market, cheese consumption has increased 123 percent since 2000, and total imports of cheese have increased over 600 percent during that same time to a total of \$26.4 million in sales (Chinese Customs). Growth is largely due to increased sales in the HRI sector. Foreign fast food restaurants like McDonalds, KFC and Pizza Hut use cheese in a variety of their meals and this exposure is slowly building the cheese market.

**Table 4: Chinese Household Purchases of Dairy Products Annually**



Like other dairy products, the key demographic for cheese are young urban children whose families more likely to have higher incomes and be exposed to western products early on. Unlike yogurt and milk, cheese has not yet been widely embraced in the Chinese mass market. Yogurt and products with small amounts of milk are likely easier to digest for lactose intolerant people, while cheese is more acceptable to those who have grown up consuming dairy.

The majority of Chinese dairy consumption does occur in urban areas like Shanghai, while rural areas continue to view dairy products as only a supplemental food source. Moreover, while milk and yogurt are produced locally as well as imported, cheese remains primarily an import product (see Appendix B for tariff rates) and is not widely available outside of major metropolitan areas due to the problems of cold-chain logistics and quality/safety standards through improper transportation and handling. Only recently have domestic Chinese dairy operations explored producing cheese.

## Competition

The current import market is dominated by New Zealand and Australia with a combined market share of 74 percent (China Customs, 2005 data). The U.S. share comes in third with 5.6 percent, however that share is growing due to the weakness of the U.S. dollar and tight supply of cheese from traditional producers throughout the world (see Appendix A). Two of the biggest dairy companies that supply cheese from the U.S. are Land O'Lakes and Kraft. Chinese consumers have yet to develop any brand loyalty due to the relatively new market, and the potential is there to increase awareness of U.S. cheese through consumer education and retail development events.

Consolidation of domestic production is changing the Chinese dairy industry. In the late 1990s, China went from 700 dairy processors to more than 1,600 by 2004. Of those, three companies have emerged as leaders. Shanghai Bright Dairy company and two companies Yili and Mengniu from Inner-Mongolia enjoy a combined 42.36 percent market share (CH6603). Due to the large number of firms, there is intense competition within the marketplace, and extensive consolidation is expected to continue in the industry. Cheese is spared some of this competition as there is little local processing occurring due to lack of infrastructure and knowledge. Only a small number of domestic firms like Bright Dairy offer locally produced or packaged cheese.

After suffering heavy losses during the consolidation, a few foreign firms are re-entering the Chinese dairy market. In 2005, the French company Groupe Danone increased its stake in the Shanghai Bright Dairy in order to access China's growing dairy market. Other leading companies are following suit by entering into the market through domestic dairy companies. Arla Foods, a European company, has entered into a joint-venture with Mengniu, and New Zealand based Fonterra has partnered with Shijiazhuang's San Lu Group.

## Food Service-HRI (Hotel, Restaurant, Institution)

The majority of cheese consumed in Shanghai is through the HRI sector. Western-oriented fast food restaurants like McDonalds, KFC, and Pizza Hut contribute heavily toward cheese consumption in the mass market. Other sources for cheese include hotels that cater to western clientele as well as the more high-end restaurants with similar business. Expatriate consumption remains high at all these venues. U.S. firms have relatively little involvement with this segment of the market with only 10 percent of all U.S. imported cheese going to the HRI sector. Other countries like New Zealand and Australia are active in HRI with roughly 50 percent of their imports going to that segment.

## Retail

Few Chinese incorporate cheese into their daily meals and at best consume other dairy products like milk or yogurt. Many western-oriented or high-end retail outlets provide cheese for retail, though some smaller markets are beginning to stock cheese as tastes for

western food grow. The majority of retail sales are processed cheese. Spreadable cream cheese makes up roughly a third of this market while the rest is composed mainly of processed cheese slices (CH6603). Due to the unfamiliarity of cheese in the Chinese diet, relatively bland cheeses like mozzarella, mild cheddar, and parmesan fit the market well. U.S. companies like Kraft and Land O'Lakes do well in producing for this part of the market with nearly 90 percent of U.S. imports going to retail. More rich or sharp cheeses are typically found only in high-end retail or expatriate-oriented food shops.

## Potential Obstacles

The U.S. cheese industry must overcome several key obstacles before it can successfully develop the Chinese market. Compared to competition from European and Oceanic countries, U.S. cheese has, on average, a higher price and a shorter shelf life due to regulations concerning the determination of shelf life. In the U.S., most fresh cheese that is packaged and shipped has an average shelf life of roughly 4 months. Oceanic countries like Australia and New Zealand have a typical shelf life on 9-12 months due to a different formulation methods of shelf life that include calculating acceptable moisture levels and fat content. Most fresh cheese that arrives in China takes 2 weeks for shipment and another 2 weeks to a month for customs declaration, leaving U.S. cheese with only 2 1/2 to 3 months of shelf time. This is a problem for most retailers and distributors who take risk in stocking a product that may not sell. Chinese retailers will avoid such risks and source from Oceanic producers who can guarantee longer preservation times and a longer opportunity to sell. The California Polytechnic State University is currently researching ways to produce and package U.S. cheese that adds additional shelf life.

U.S. cheese also does not carry the same brand power as other U.S. products like beef or pork. This is a market-wide problem with other countries facing similar problems due to cheese being a new and small market. Brand name recognition will be crucial to any potential producer exporting to the Shanghai market.

Other system-wide problems include the relatively urban nature of dairy consumption. The urban and rural divide in income mirrors the urban and rural divide in total household expenditures on dairy products. Cheese is severely affected by this as cheaper dairy products like milk are more affordable and available for rural Chinese. Also, cold-chain logistics plays a role in keeping cheese centered in urban areas. China's cold-chain is lengthy and inefficient, and imported products face problems when shipped from coastal zones into western China.

## ATO Events

ATO Shanghai has worked closely with organizations like the U.S. Dairy Export Council (USDEC) to promote cheese products. Earlier this year 13 retail development events were conducted with major hypermarket carriers including Carrefour, Wal-Mart, Lotus and Metro to promote different varieties of U.S. cheese. Statistics are not available from those events, but sales were determined to have increased greater than expected during and after the events. USDEC is also in negotiation with Metro to do an all China retail development event for cheese. Other events include a research and development team from Western Farms (one of the biggest dairy operations in the U.S.) analyzing the market potential for future growth in China, as well as a Cold Chain seminar which discussed the problems with transportation of chilled and/or frozen products in China, including cheese.

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## Appendix

### Appendix A: U.S. Cheese Exports to China, 2000-2005

COMMODITY	HS TARIFF CODE	Value (1,000 U.S. dollars)/Year						% CHANGE '04-'05
		2000	2001	2002	2003	2004	2005	
CHEESE, ALL KINDS	0406200000	45	8	47	93	294	189	-35.8
CHEESE, INC MIXT	0406909550	17	33	30	16	138	890	543.1
CHEESE, PROCESSED	0406300000	3	0	0	0	8	33	286.2
CHEESE, CHEDDAR	0406901000	0	0	0	11	7	72	983.7
FRESH CHEESE	0406100000	0	0	0	5	3	10	248.3
TOTAL		66	41	77	126	451	1,193	164.5

Source: U.S. Trade Data

### Appendix B: Cheese Tariff Rates in China

	Before WTO Entry	After WTO Entry (2002)	2006
Fresh Cheese	50%	27%	10%
Grated/powdered cheese	50%	27%	12%
Processed cheese	50%	27%	12%
Blue-veined cheese	50%	27%	12%
Other cheese	50%	27%	12%

Source: Chinese Customs